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U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

☒ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended September 30, 2010

☐ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from __________ to __________.

Commission File Number 001-34661

Dehaier Medical Systems Limited

(Exact name of registrant as specified in its charter)

British Virgin Islands	Not Applicable
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer identification number)

Room 908, East Plaza
No. 15 West 4th Ring North Road
Haidian District, Beijing, 100195
People's Republic of China
(Address of principal executive offices and zip code)

(8610) 5166-0080

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) Yes ☒ No ☐; and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☐ (Do not check if a smaller reporting company)	Smaller reporting company	☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

The Company is authorized to issue 18,307,038 Shares. As of the date of this report, the Company has issued and outstanding 4,500,000 Shares.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We have made statements in this quarterly report that constitute forward-looking statements. Forward-looking statements involve risks and uncertainties, such as statements about our plans, objectives, expectations, assumptions or future events. In some cases, you can identify forward-looking statements by terminology such as “anticipate,” “estimate,” “plan,” “project,” “continuing,” “ongoing,” “expect,” “we believe,” “we intend,” “may,” “should,” “could” and similar expressions. These statements involve estimates, assumptions, known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from any future results, performances or achievements expressed or implied by the forward-looking statements.

Examples of forward-looking statements include:

- projections of revenue, earnings, capital structure and other financial items;
- statements of our plans and objectives;
- statements regarding the capabilities and capacities of our business operations;
- statements of expected future economic performance; and
- assumptions underlying statements regarding us or our business.

The ultimate correctness of these forward-looking statements depends upon a number of known and unknown risks and events. Many factors could cause our actual results to differ materially from those expressed or implied in our forward-looking statements. Consequently, you should not place undue reliance on these forward-looking statements.

The forward-looking statements speak only as of the date on which they are made, and, except as required by law; we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events.

In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to update this forward-looking information. Nonetheless, the Company reserves the right to make such updates from time to time by press release, periodic report or other method of public disclosure without the need for specific reference to this Report. No such update shall be deemed to indicate that other statements not addressed by such update remain correct or create an obligation to provide any other updates.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

See the financial statements following the signature page of this report, which are incorporated herein by reference.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our company's financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes included elsewhere in this report. In this report, the terms "we," "the Company," "our company," and "our" refer to Dehaier Medical Systems Limited, a British Virgin Islands company ("Dehaier"), Dehaier Medical Systems (Hong Kong) Limited, our subsidiary in Hong Kong ("DHK"), Beijing Dehaier Technology Company Limited, our variable interest entity in the People's Republic of China ("BTL") and Beijing Dehaier Medical Technology Company Limited, our operating subsidiary in the People's Republic of China ("BDL"). This discussion contains forward-looking statements that involve risks and uncertainties. Actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of various factors.

This section should be read together with the consolidated financial statements and related notes thereto in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009, as well as the condensed consolidated financial statements for the three and nine month periods ended September 30, 2010 and accompanying notes included elsewhere in this document.

Overview

We have been focused on the development and distribution of medical devices since our inception, and we began developing our respiratory and oxygen homecare business in 2006. We design, develop and market our branded products in China. We import the majority of the products and medical components we sell to our customers. We design and develop some of the medical components that are part of the branded products to be distributed. Some of these medical components are manufactured by contractors in China because we do not have a manufacturing facility. Most of our branded products require light assembly.

In addition to our branded products, we also serve as a distributor of products designed and manufactured by other companies. We sell products from Penlon (UK), HEYER (Germany), Welch Allyn (US), IMD (Italy), Timesco (UK), ResMed (Australia) and JMS (Japan).

We sell products primarily to distributors; however, we also sell products directly to hospitals, clinics and government health bureaus. We continually seek to broaden our market reach by introducing new and more advanced products and new product lines that address different end-user populations.

For the nine months ended September 30, 2010 and 2009, our total revenues amounted to approximately $12.9 million and $9.42 million, respectively. For the three month periods ended September 30, 2010 and 2009, our total revenues amounted to approximately $5.46 million and $3.59 million, respectively. Our revenues are subject to value added tax ("VAT"), sales returns and trade discounts. We deduct these amounts from our gross revenues to arrive at our total revenues. Our net income attributable to Dehaier was $3.07 million and $2.07 million for the nine month periods ended September 30, 2010 and 2009, respectively, and $1.41 million and $1.02 million for the three month periods ended September 30, 2010 and 2009, respectively.

Revenues

Our total revenues are derived from products we provide in our three product lines, (i) Medical Devices (ii) Respiratory and Oxygen Homecare Products and (iii) Technical Service Products. We currently operate in one business segment for all of our products we distribute.

Medical Devices – Our Branded and Distributed Products

We derive revenues in our medical devices product line from the sale of C-arm X-ray systems, anesthesia machines, patient monitors and general hospital products. Our medical device line is our largest business line of products and has the most extensive market penetration of our three product lines. We anticipate that we will continue to experience revenue growth in our medical devices line as we further penetrate the market through the development and introduction of new advanced product offerings.

Respiratory and Oxygen Homecare Products – Our Branded and Distributed Products

We derive revenues in our respiratory and oxygen homecare line from sales of oxygen concentrators, CPAP devices, portable sleep screening and diagnostic devices and thermotherapy devices. We anticipate that, on a percentage basis, net revenues in our respiratory and oxygen homecare product line will increase more rapidly than total net revenues in the near term, as we introduce new and more advanced products in this product line. We expect to increase our market penetration in the respiratory and oxygen homecare market both in China and internationally through the use of distributors as well as through our direct sales platform.

Technical Service Products – Our Branded Products

We derive revenues in our technical service products line from sales of our air compressors and ventilator trolleys. We anticipate continued growth in revenues from our technical service products as we further penetrate this market by increasing the number of our distributors and maintaining a competitive pricing model.

Our ability to increase our revenues depends in large part on our ability to (i) increase the market penetration of our existing products, (ii) successfully identify, develop, introduce and commercialize, in a timely and cost-effective manner, new and upgraded products and (iii) enter into international markets in the future. Generally, we choose to devote our resources to product development efforts that we believe are commercially feasible, can generate significant revenues and margins and can be introduced into the market quickly.

Factors Affecting Our Results of Operations – Generally

We believe the most significant factors that directly or indirectly affect our sales revenues and net income are:

- global economic conditions;
- the changes in China's macro-economic environment and healthcare-related government strategies and policies;
- the level of acceptance of our products among hospitals and other healthcare facilities;
- our ability to attract and retain distributors, key customers and our direct sales force;
- new product introductions by us and our competitors; and
- our ability to price our products at levels that provide favorable margins.

Operating Costs and Expenses

Our operating costs and expenses consist of cost of revenues, general and administrative expenses, selling expenses and other expenses. Our total operating costs and expenses decreased as a percentage of our total revenues for the nine and three months ended September 30, 2010 compared to the same period in 2009 primarily due to increased economies of scale and an increase in revenue. The following table sets forth the components of our costs and expenses both in U.S. dollar amounts (in thousands) and as a percentage of total net revenues for the periods indicated.

	For the nine months ended Sep. 30 (Unaudited)				For the three months ended Sep. 30 (Unaudited)			
	2010		2009		2010		2009	
	USD ('000)	%	USD ('000)	%	USD ('000)	%	USD ('000)	%
Revenues	12,931	100.00	9,422	100.00	5,459	100.00	3,588	100.00
Costs and expenses								
Cost of revenues	7,777	60.14	5,688	60.38	3,199	58.60	2,102	58.59
General and administrative expense	876	6.78	788	8.36	355	6.50	159	4.43
Selling expense	834	6.45	544	5.77	351	6.43	153	4.26
Total costs and expenses	9,487	73.37	7,020	74.51	3,905	71.53	2,414	67.28

Cost of revenues

Cost of revenues primarily includes wages, parts for assembly, handling charges, and other expenses associated with the assembly and distribution of product. While our costs of revenues may decrease as a percentage of our total revenues due to economies of scale, our total costs of revenues are expected to increase in absolute dollars as our revenues grow.

General and Administrative Expenses

General and administrative expenses consist primarily of salaries and benefits and related costs for our administrative personnel and management, fees and expenses of our outside advisers, including legal, audit and valuation expenses, expenses associated with our administrative offices and the depreciation of equipment used for administrative purposes. We expect that our general and administrative expenses will increase, both on an absolute basis and as a percentage of revenue, as we hire additional personnel and incur costs related to the anticipated growth of our business. In addition, we expect to incur additional general and administrative expenses associated with being a public company.

Selling Expenses

Selling expenses primarily consist of compensation and benefits for our sales and marketing staff, expenses for promotional, advertising, travel and entertainment activities, lease payments for our sales offices, and depreciation expenses related to equipment used for sales and marketing activities. Going forward, we expect our selling expenses to increase, both on an absolute basis and as a percentage of revenue, as we increase our efforts to promote our products, especially our new respiratory and oxygen homecare products.

Results of Operations

Our limited operating history makes it difficult to predict future operating results. We believe that period-to-period comparisons of operating results should not be relied upon as indicative of future performance.

Nine Months Ended September 30, 2010 Compared to Nine Months Ended September 30, 2009

Revenues

Our total revenues increased by approximately 37% from $9.422 million for the nine months ended September 30, 2009 to $12.931 million for the nine months ended September 30, 2010. The increase in revenues was due to the increased acceptance of our products among hospitals and other healthcare facilities as many of our end users such as hospitals became repeat customers when they needed new medical equipment. We also signed exclusive distribution agreements with Penlon, HEYER, and Welch Allyn expanding our product lines in 2010 and contributing to our revenue growth.

Cost of Revenues

Our cost of revenues increased approximately 37% from $5.69 million for the nine months ended September 30, 2009 to $7.78 million for the nine months ended September 30, 2010. Our cost of revenues grew in U.S. dollars in line with revenue growth.

Operating Expenses

Our operating expenses for the nine months ended September 30, 2010 were approximately $1.71 million, which increased 28% compared with $1.33 million in the same period in 2009. The reasons for this increase are described below.

Operating Expenses—General and Administrative Expenses

General and administrative expenses consist primarily of salaries and benefits and related costs for our administrative personnel and management and expenses associated with our research and development and the registration of foreign exchange certificate.

Our general and administrative expenses increased by approximately 11% from $0.79 million for the nine months ended September 30, 2009 to $0.88 million for the nine months ended September 30, 2010. This increase is mainly due to two reasons. First, pursuant to our market expansion strategy, we opened new CECs (Customer Experience Centers) in China during the third quarter of 2010, which need initial investment at the very beginning. Second, we incurred implementation expenses for Sarbanes-Oxley Section 404 compliance.

We expect that our general and administrative expenses will increase in the near term. We anticipate using a portion of the net proceeds from our initial public offering to expand our marketing efforts in order to continue to grow our revenues in China and internationally. Among other strategies to expand our business, we plan to open more new CECs, to strengthen our market presence in China. These CECs could give our potential customers an opportunity to experience our products first-hand in an environment that is similar to the environment in which they will use the products, whether that is a home or healthcare facility.

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Operating Expenses—Selling Expenses

Our selling expenses increased approximately 54% from $0.54 million for the nine months ended September 30, 2009 to $0.83 million for the nine months ended September 30, 2010.

Our selling expenses primarily consist of salaries and related expenses for personnel engaged in sales, marketing and customer support functions and costs associated with advertising and other marketing activities. Our selling expenses increased for the nine months ended September 30, 2010, mainly due to an increase in our sales staff to further strengthen our the distribution network in the second quarter of 2010. We also participated in several medical exhibitions in and outside of China to network with our old and new customers.

We expect that our selling expenses will increase in the near term after our series of new products are introduced in the market. We tend to promote our new products by different advertising methods, such as to participate in domestic and overseas medical exhibitions to show our products to the public and potential purchasers.

Operating Income

As a result of the foregoing, we generated operating income of approximately $3.61 million for the nine months ended September 30, 2010, compared to approximately $2.59 million for the nine months ended September 30, 2009. Operating income increased approximately 39% largely due to the increase of revenues.

Taxation

Our income tax expense was approximately $0.54 million for the nine months ended September 30, 2010, compared to approximately $0.41 million for the nine months ended September 30, 2009. Our taxable income increased primarily due to increased taxable income.

Net Income

As a result of the foregoing, we had net income of approximately $3.08 million for the nine months ended September 30, 2010, compared to approximately $2.11 million for the nine months ended September 30, 2009. After deduction of non-controlling interest in income, net income attributable to Dehaier was approximately $3.07 million and $2.07 million for the nine months ended September 30, 2010 and 2009, respectively.

Three Months Ended September, 2010 Compared to Three Months Ended September 30, 2009

Revenues

Our total revenues increased by approximately 52% from $3.59 million for the three months ended September 30, 2009 to $5.46 million for the three months ended September 30, 2010. The increase in revenues was due to the increased acceptance of our products among hospitals and other healthcare facilities as many of our end users such as hospitals became repeat customers when they needed new medical equipment. We also signed exclusive distribution agreements with Penlon, HEYER, and Welch Allyn in expanding our product lines in the second quarter, 2010 and contributing to our revenue growth.

Cost of Revenues

Our cost of revenues increased approximately 52% from $2.10 million for the three months ended September 30, 2009 to $3.20 million for the three months ended September 30, 2010. Our cost of revenues grew in U.S. dollars in line with revenue growth.

Operating Expenses

Our operating expenses increased by approximately 129% from $0.31 million for the three months ended September 30, 2009 to $0.71 million for the three months ended September 30, 2010. This increase was due to increase in selling expenses for the reasons described below.

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Operating Expenses—General and Administrative Expenses

General and administrative expenses consist primarily of salaries and benefits and related costs for our administrative personnel and management and expenses associated with our research and development and the registration of foreign exchange certificate.

Our general and administrative expenses increased by approximately 125% from $0.16 million for the three months ended September 30, 2009 to $0.36 million for the three months ended September 30, 2010. This increase is mainly due to three reasons: First, market expansion strategy, we opened new CECs (Customer Experience Centers) in China during the third quarter of 2010, which need initial investment at the very beginning. Second, we incurred implementation expenses for Sarbanes-Oxley Section 404 compliance. Third, we increased our research expense on our branded products as well as our distributed products.

We expect that our general and administrative expenses will increase in the near term. We anticipate using a portion of the net proceeds from our initial public offering to expand our marketing efforts in order to continue to grow our revenues in China and internationally. Among other strategies to expand our business, we plan to open more new CECs, to strengthen our market presence in China. These CECs could give our potential customers an opportunity to experience our products first-hand in an environment that is similar to the environment in which they will use the products, whether that is a home or healthcare facility.

Operating Expenses—Selling Expenses

Our selling expenses increased by approximately 133% from $0.15 million for the three months ended September 30, 2009 to $0.35 million for the three months ended September 30, 2010.

Our selling expenses primarily consists of salaries and related expenses for personnel engaged in sales, marketing and customer support functions and costs associated with advertising and other marketing activities. Our selling expenses increased for the three months ended September 30, 2010, mainly due to an increase in our sales staff in further strengthening our distribution network in the third quarter of 2010. We also participated in several medical exhibitions in and outside of China to network with our old and new customers.

We expect that our selling expenses will increase in the near term after our series of new products are introduced in the market. We tend to promote our new products by different advertising methods, such as to participate in domestic and overseas medical exhibitions to show our products to the public and potential purchasers.

Operating Income

As a result of the foregoing, we generated operating income of approximately $1.61 million for the three months ended September 30, 2010, compared to approximately $1.24 million for the three months ended September 30, 2009. Operating income increased approximately 30% largely due to the increase of revenues.

Taxation

Our income tax expense was approximately $0.25 million for the three months ended September 30, 2010, compared to approximately $0.18 million for the three months ended September 30, 2009. Our taxable income increased primarily due to increased taxable income.

Net Income

As a result of the foregoing, we had net income of approximately $1.41 million for the three months ended September 30, 2010, compared to approximately $1.03 million for the three months ended September 30, 2009. After deduction of non-controlling interest in income, net income attributable to Dehaier was approximately $1.41 million and $1.02 million for the three months ended September 30, 2010 and 2009, respectively.

Liquidity and Capital Resources

Cash Flows and Working Capital

To date, we have financed our operations primarily through cash flows from issuance of common shares. As of September 30, 2010, we had approximately $4.96 million in cash and cash equivalents. As a result of the total cash activities, net cash increased from $1,151,721 at December 31, 2009 to $4,964,450 at September 30, 2010. We believe that our currently available working capital of $18,011,309, including cash of $4,964,450, should be adequate to meet our anticipated cash needs and sustain our current operations for at least 12 months.

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Operating Activities

Net cash used in operating activities was $5,696,022 for the nine months ended September 30, 2010 as compared to $1,573,390 net cash provided by operating activities for the same period in 2009.

(i) Increase of $971,480 in net income. Our net income increased primarily because of a growth in sales volume in 2010.

(ii) Increase of $4,433,546 in prepayment. The increase in prepayment is attributable to signing some large new sales contracts in second quarter of 2010, which required us to order and pay for products in advance.

(iii) Increase of $1,608,240 in other receivables. The increase in other receivable is mainly caused by our contract bidding deposits and guaranty. As we begin to expand our business and our product lines, we need to pay a portion of the contract amounts to our customers as bidding deposits or guaranty, and our customers will return these deposits to us, generally in 3-6 months.

(iv) Increase of $1,969,143 in inventories. The increase in inventories is attributable to the following two reasons: 1) We incurred inventory to meet anticipated sales needs. 2) As we signed some exclusive distribution agreements with Penlon, HEYER, and Welch Allyn to expand our product line in third quarter of 2010, we had to stock our inventories with these manufacturers' products.

Investing Activities

Net cash used in investing activities for the nine months ended September 30, 2010 was $843,317, compared to net cash used in investing activities of $913,717 for the nine months ended September 30, 2009. The cash used in investing activities was mainly attributable to capital expenditures for the purchase of new equipment.

Financing Activities

Net cash provided by financing activities for the nine months ended September 30, 2010 and 2009 was $9,944,207 and $0, respectively. The cash provided by financing activities for the nine months ended September 30, 2010 was due to net proceeds from our IPO.

Contractual Obligations and Commercial Commitments

The following table sets forth our contractual obligations as of September 30, 2010:

	Payments due by period			
		Less than		More than
Contractual obligations	**Total**	**1 year**	**1-3 years**	**3 years**
Operating Lease Obligations	$ 221,000	$ 156,000	$65,000	—
Short-term borrowings	$1,495,000	$1,495,000	—	—
Total	$1,716,000	$1,651,000	$65,000	—

The leased properties are principally located in the PRC, and we use such properties for administration and warehouse facilities. The leases are renewable subject to negotiation.

Short-term borrowings represent short-term loans from a bank which is due in September 2011.

Capital Expenditures

Our capital expenditures were $839,456 and $915,693 for the nine months ended September 30, 2010 and 2009, respectively, representing 6.49% and 9.72% of our total revenues, respectively. Our capital expenditures may increase in the near term as our business continues to grow and as we expand and improve our financial and accounting systems and infrastructure.

Off-Balance Sheet Commitments and Arrangements

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as shareholder’s equity or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

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Tax Matters Applicable to Our Company

Generally

Dehaier is a tax-exempt company incorporated in the British Virgin Islands. BDL and BTL were incorporated in the PRC and are governed by PRC laws. DHK is subject to Hong Kong profits tax rate.

Our company pays PRC enterprise income taxes, value added taxes and business taxes in China for revenues from BDL and is governed by British Virgin Islands tax laws as to Dehaier.

British Virgin Islands Tax

We are exempt from all provisions of the Income Tax Act of the British Virgin Islands, including with respect to all dividends, interests, rents, royalties, compensation and other amounts payable by or to persons who are not resident in the British Virgin Islands. Capital gains realized with respect to any of our shares, debt obligations or other securities by persons who are not resident in the British Virgin Islands are also exempt from all provisions of the Income Tax Act of the British Virgin Islands. No estate, inheritance tax succession or gift tax rate, duty, levy or other charge is payable by persons who are not resident in the British Virgin Islands with respect to any of our shares, debt obligations, or other securities. No stamp duty is payable in the British Virgin Islands in relation to a transfer of shares in a British Virgin Islands Business Company.

PRC Enterprise Income Taxes

PRC enterprise income tax is calculated based on taxable income determined under PRC accounting principles. According to the Foreign-invested Enterprises and Foreign Enterprises Income

Tax Law (the “FIE Income Tax Law”) and the related implementing rules, both of which issued in 1991, foreign-invested enterprises established in China are generally subject to an income tax rate of 33% (consisting of 30% enterprise income tax and 3% local income tax). The FIE Income Tax Law and the related implementing rules provide certain favorable tax treatments to qualified foreign invested enterprises.

The FIE Income Tax Law was replaced by the Enterprise Income Tax Law (the “EIT Law”) as of January 1, 2008. Under the EIT Law, a unified enterprise income tax rate of 25% and unified tax deduction standards will be applied equally to both domestic-invested enterprises and foreign-invested enterprises. Enterprises established prior to March 16, 2007 eligible for preferential tax treatment in accordance with the currently prevailing tax laws and administrative regulations shall, under the regulations of the State Council, gradually become subject to the EIT Law rate over a five-year transition period starting from the date of effectiveness of the EIT Law. The details of the transitional arrangement for the five-year period from January 1, 2008 to December 31, 2012 applicable to enterprises approved for establishment prior to March 16, 2007, such as our company, were adopted in January 2008.

Furthermore, under the EIT Law, an enterprise established outside of the PRC with “de facto management bodies” within the PRC is considered a resident enterprise and will normally be subject to the enterprise income tax at the rate of 25% on its global income. If the PRC tax authorities subsequently determine that we or any of our non-PRC subsidiaries should be classified as a PRC resident enterprise, then such entity’s global income will be subject to PRC income tax at a tax rate of 25%. In addition, under the EIT Law, payments from BDL to us may be subject to a withholding tax. The EIT Law currently provides for a withholding tax rate of 20%. If Dehaier is deemed to be a non-resident enterprise, then it will be subject to a withholding tax at the rate of 10% on any dividends paid by its Chinese subsidiaries to Dehaier. In practice, the tax authorities typically impose the withholding tax rate of 10% rate, as prescribed in the implementation regulations; however, there can be no guarantee that this practice will continue as more guidance is provided by relevant government authorities. We are actively monitoring the proposed withholding tax and are evaluating appropriate organizational changes to minimize the corresponding tax impact.

The State Council issued the “Notice on Implementation of the Transition Period for Preferential Enterprise Income Tax,” or the “Transition Implementation Notice,” on December 26, 2007, which provides detailed rules on how preferential tax rates under previous income tax laws or regulations would transition to the uniform 25% EIT rate. In addition, entities that qualify as “high and new technology enterprises” will enjoy a 15% preferential tax rate under the EIT Law. The Ministry of Science and Technology, the Ministry of Finance and the State Administration of Taxation issued the “Measures on Qualification of High and New Technology Enterprises,” or “Circular 172,” on April 14, 2008, which provides detailed standards for “high and new technology enterprises.” In addition, according to the Notice on Prepayment of Enterprise Income Tax issued by the State Administration of Taxation, enterprises that have been certified as “high and new technology enterprises” shall pre-pay EIT at the rate of 25% temporarily until re-certified as “high and new technology enterprises” under Circular 172.

Under the current PRC laws, PRC government grants a preferential income tax rate of 15% to government-certified high technology companies, and under the new standard the period of validity for the certification of high technology companies is three years. In 2009, BDL updated its certification for "high technology" company. Therefore, BDL used a 15% income tax rate to calculate the income tax expense for periods ended September 30, 2010 and 2009. The tax rate for BTL is 25% in 2009 and 2010.

PRC Value Added Tax

Pursuant to the Provisional Regulation of China on Value Added Tax and its implementing rules, issued in December 1993, all entities and individuals that are engaged in the businesses of sales of goods, provision of repair and placement services and importation of goods into China are generally subject to a VAT at a rate of 17% (with the exception of certain goods which are subject to a rate of 13%) of the gross sales proceeds received, less any VAT already paid or borne by the taxpayer on the goods or services purchased by it and utilized in the production of goods or provisions of services that have generated the gross sales proceeds.

PRC Business Tax

Companies in China are generally subject to business tax and related surcharges by various local tax authorities at rates ranging from 3% to 20% on revenue generated from providing services and revenue generated from the transfer of intangibles.

Critical Accounting Policies

Presentation in Accordance with US GAAP

We prepared the accompanying condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). These accounting principles require us to make judgments, estimates and assumptions on the reported amounts of assets and liabilities at the end of each fiscal period, and the reported amounts of revenues and expenses during each fiscal period. We continually evaluate these judgments and estimates based on our own historical experience, knowledge and assessment of current business and other conditions, our expectations regarding the future based on available information and assumptions that we believe to be reasonable.

Basis of Consolidation

The condensed consolidated financial statements include the accounts of Dehaier, BDL, its majority-owned subsidiary, and its wholly-owned subsidiary, DHK as well as BTL. All significant inter-company transactions and balances are eliminated in consolidation.

A group of shareholders, including the Chief Executive officer, originally held more than 50% of the voting ownership interest of Dehaier, BDL and BTL. BTL is a variable interest entity, and BDL is the primary beneficiary. BTL owns a building which is pledged as collateral for BDL's bank loans. In exchange, BDL loans money to BTL to finance its operations. BTL's primary operation is to provide repairs and transportation services to BDL's customers. Because of these arrangements, BDL is the primary beneficiary of BTL, as the entity that is most closely associated with BTL. Dehaier has included BTL in its consolidated financial statements through the consolidation with BDL since

December 31, 2006. Dehaier, BDL and BTL were under common control until October 31, 2009, when each share of preferred share was converted into a common share. Because the chief executive officer held more than 50% of the voting ownership interest of each of Dehaier, BDL, BTL and DHK at December 31, 2006, the Company initially measured the assets, liabilities and noncontrolling interest of the variable interest entity at the amounts at which they were carried in the accounts of the reporting entity that controls the variable interest entity pursuant to FASB ASC 810-10.

On October 31, 2009, BDL reconsidered whether it was the primary beneficiary of BTL when Dehaier's preferred stock was converted into common shares. While such conversion dilutes the chief executive officer's interest in BDL such that BDL and BTL are not under common control after October 31, 2009, BDL still has the obligation to absorb the expected losses of BTL. BTL is still a variable interest entity because all of its activities either involve or are conducted on behalf of the reporting enterprise and its related parties. BDL is BTL's only customer referral source. On March 3, 2010, BDL entered into a Loss Absorption Agreement memorializing the understanding that BDL would continue to loan money to BTL as needed to fund its working capital such that BDL would absorb BTL's losses.

The accounts of BTL are consolidated in the accompanying financial statements pursuant to Accounting Standards Codification ("ASC") 810-10, "Consolidation". As a VIE, BTL's revenues are included in the Company's service income, and its income from operations is consolidated with the Company's. Because of the arrangements, the Company had a pecuniary interest in BTL that requires consolidation of the Company's and BTL's financial statements.

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On January 1, 2009, the Company adopted the transition rules within ASC 810-10-65, regarding accounting and reporting standards for the non-controlling interest in a subsidiary.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Estimates are adjusted to reflect actual experience when necessary. Significant accounting estimates reflected in the Company's consolidated financial statements include revenue recognition, allowance for doubtful accounts and impairment of long-lived assets. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments which are unrestricted as to withdrawal or use, and which have maturities of three months or less when purchased. Our company maintains uninsured cash and cash equivalents with various financial institutions mainly in the PRC and Hong Kong.

Accounts Receivable

Accounts receivable are recorded at net realizable value. Accounts receivable terms typically are 60-180 days from the end of the month in which services are provided or goods are delivered. Our typical trade receivable terms vary based on the type of customer. We general require 100% prepayment before delivering our products to individual clients. Our contract terms general require 10%-30% prepayment for our hospital and healthcare center clients, and the trade receivable term in contracts for those clients is generally between 60 and 90 days. Our contract terms general require 10% prepayment from our distributor clients, and the trade receivable term in contracts for those clients is generally between 60 and 180 days. With the exception of the prepayments we require in some cases, our company generally does not require collateral or other security to support accounts receivable. An allowance, if required, is based on a combination of historical experience, aging analysis, and an evaluation of the collectability of specific accounts.

Receivables are considered past due after 3 years and written off. Management has determined this write-off policy by reviewing the decrease in likelihood of collection as a function of time and concluded that collectability of accounts receivable after three years was significantly impaired, compared with collectability prior to such time. At September 30, 2010 and December 31, 2009, an allowance for doubtful accounts has been provided based on historical experience and management's analysis of performance and current aging of accounts receivable. Based on this analysis, management believes that its historical bad debt rates and long-term accounts receivable (over one year) are relatively low and that, as a result, the allowance for doubtful accounts is adequate.

Fair Value of Financial Instruments

The carrying amounts reported in the consolidated financial statements for current assets and current liabilities approximate fair value due to the short-term nature of these financial instruments.

The Company follows the provisions of ASC 820-10, "Fair Value Measurements and Disclosures", which establishes a single authoritative definition of fair value and a framework for measuring fair value and expands disclosure of fair value measurements for both financial and nonfinancial assets and liabilities. This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. This standard does not require any new fair value measurements, but discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flows) and the cost approach (cost to replace the service capacity of an asset or replacement cost). For purposes of ASC 820-10-15, nonfinancial assets and nonfinancial liabilities would include all assets and liabilities other than those meeting the definition of a financial asset or financial liability as defined in ASC 820-10-15-15-1A.

On August 26, 2009, the FASB issued Accounting Standard Update (ASU) 2009-05, Measuring Liabilities at Fair Value, to clarify how entities should estimate the fair value of liabilities under the FASB ASC Topic 820, Fair Value Measurements and Disclosures. The amendments in ASU 2009-05 reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. Therefore, preparers, investors, and other users of financial statements will have a better understanding of how the fair value of liabilities was measured, helping to improve consistency in the application of Topic 820. The FASB issued ASU 2009-05 as a result of expressed concern that there may be a lack of observable market information to measure the fair value of a liability. For example, in the hypothetical transfer of an asset subject to a restriction there will be no observable data available to measure the liability because it is restricted from being transferred. This guidance is effective for the first reporting period (including interim periods) beginning after issuance.

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The Company adopted the provisions of ASC Topic 815 (formerly Emerging Issue Task Force 07-5), “Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity’s Own Stock”. ASC Topic 815 provides a framework for determining whether an instrument is indexed to an entity’s own stock. ASC Topic 815 became effective for the Company this period when warrants were issued in connection with the Company’s initial public offering (“IPO”). Such warrants are indexed to the Company’s common shares, which is traded in US dollars. Since the Company’s functional currency is the RMB, such warrants are considered liabilities. The fair value of the warrant liabilities is measured each reporting period with the resulting change in fair value recorded in the statement of operations.

Inventories

Inventories are stated at the lower of cost or market and consist of assembled and unassembled parts relating to medical devices. The Company reviews its inventories annually for possible obsolete goods and to determine if any reserves are necessary.

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. When these events occur, the Company measures impairment by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from the use of the asset and eventual disposition. If the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment loss, equal to the excess of the carrying amount over the fair market value of the asset, is recognized. Management has determined no impairment exists at the balance sheet dates.

Revenue Recognition

The Company recognizes revenues when all the followings conditions have been satisfied:

- Persuasive evidence an arrangement exists;
- Delivery and/or installation has occurred (e.g., risks and rewards of ownership have passed);
- The sales price is fixed or determinable; and
- Collectability is reasonably assured.

All revenues are based on firm customer orders with fixed terms and conditions. Because the products are assembled to the customers’ specification, there is no right of return. The Company does not provide its customers with price protection or cash rebates. For products which include software, the software is an off-the-shelf package and an integral part of the products being delivered. The Company does not provide any significant post-sale customer support services and does not provide customers with upgrades. The software is incidental to the product as a whole. For products that do not require installation, revenues are recognized when the products are delivered. For products that require installation, revenues are recognized when the installation is completed.

Value Added Tax

In the PRC, a VAT rate of 17% of the invoice amount is collected in respect of the sales of goods on behalf of tax authorities. The VAT collected is not revenue of the Company; instead, the amount is recorded as a liability on the balance sheet until such VAT is paid to the authorities. The Company reports revenues net of PRC's value added tax for all the periods presented in the consolidated statements of operations.

Service Income and Expense

Service income and expense represents activities related to repairs and transportation services provided for the customers by BTL.

Warranty Costs

The Company provides for the estimated cost of product warranties at the time revenue is recognized. Warranty costs are included in general and administrative expenses. The Company's warranty obligation is affected by product failure rates and material usage and service delivery costs incurred in correcting product failure. Should actual product failure rates, material usage or service delivery costs differ from the Company's estimates, the Company may be required to revise its estimated product warranty liability. The term of the product warranty is generally twelve months.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes in accordance with ASC 740-10, "Accounting for Income Taxes." Under this method, income tax expense is recognized for the amount of: (i) taxes payable or refundable for the current year; and (ii) deferred tax consequences of temporary differences resulting from matters that have been recognized in an entity's financial statements or tax returns. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is provided to reduce the deferred tax assets reported if, based on the weight of available positive and negative evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of September 30, 2010 and December 31, 2009, the Company was not required to record any deferred tax assets or liabilities.

ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition of a tax position taken or expected to be taken on a tax return. Under ASC 740-10, a tax benefit from an uncertain tax position taken or expected to be taken may be recognized only if it is "more likely than not" that the position is sustainable upon examination, based on its technical merits. The tax benefit of a qualifying position under ASC 740-10 would equal the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all the relevant information. A liability (including interest and penalties, if applicable) is established in the financial statements to the extent a current benefit has been recognized on a tax return for matters that are considered contingent upon the outcome of an uncertain tax position. Related interest and penalties, if any, are included as components of income tax expense and income taxes payable. The Company is awaiting resolution of certain complex tax issues and has not yet filed its 2008 and 2009 Value Added Tax ("VAT") tax returns for some of its customers. However, all the potential VAT liabilities on these VAT returns were accrued and included in the accompanying consolidated financial statements.

The implementation of ASC 740-10 resulted in no material liability for unrecognized tax benefits and no material change to the beginning retained earnings of the Company. As of September 30, 2010 and December 31, 2009, the Company did not have a liability for any unrecognized tax benefits. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as income tax expense in the statement of operations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our Company maintains a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. For the purpose of improving management efficiency and effectiveness, the Company has completed a major part of the implementation of a new accounting and management information system using SAP Business One software. Our company is currently utilizing this new system.

As of September 30, 2010, our company carried out an evaluation, under the supervision of and with the participation of management, including our company's chief executive officer and chief financial officer, of the effectiveness of the design and operation of our company's disclosure controls and procedures. Based on the foregoing, the chief executive officer and chief financial officer concluded that our company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) were effective in timely alerting them to information required to be included in our company's periodic Securities and Exchange Commission filings.

Changes in Internal Control over Financial Reporting

There were no changes in our company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934) during the three or nine months ended

September 30, 2010 that have materially affected, or are reasonably likely to materially affect, our company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) None.

(b) The section entitled "Use of Proceeds" from our registration statement filed on November 12, 2009, as amended (the "Registration Statement") is incorporated herein by reference. The effective date of the Registration Statement is March 26, 2010, and the Commission file number assigned to the Registration Statement is 333-163041. The Registration Statement registered the offering of up to 1,500,000 common shares (the "Offering"). As of September 30, 2010, the Company has spent proceeds from the Offering in accordance with the following table:

Description of Use	Proposed Expenditure Amount	Actual Expenditures through September 30, 2010
Product Research and Development	$ 2,650,333	$ 1,551,882*
Marketing	3,180,399	3,151,368
Potential Acquisitions	2,120,266	—
Working Capital	2,650,333	2,527,091
Total	**$10,601,331**	**$ 7,230,341**

* $263,291 in expenditure as of June 30, 2010 have been reclassified as a result of a re-application of R&D expenses as medical device merchandise purchases upon termination of a joint development agreement.

(c) None.

Item 3. Defaults upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

The following documents are filed herewith:

Exhibit Number	Document
3(i).1	Third Amended and Restated Articles of Association of the Registrant (1)
3(ii).1	Third Amended and Restated Memorandum of Association of the Registrant (1)
4.1	Specimen Share Certificate (1)
10.1	Form of Share Option Plan (1)
10.2	Make Good Escrow Agreement (1)
10.3	Translation of lease agreement for Product Center dated September 23, 2008 (1)
10.4	Translation of lease agreement for Principal Executive Office dated December 21, 2009, effective January 1, 2010 (1)
10.5	Distribution agreement with IMD (1)
10.6	Distribution agreement with Timesco (1)
10.7	Translation of distribution agreement with JMS (1)
10.8	Distribution agreement with ResMed (1)
10.9	Translation of form of independent distributor agreement (1)
10.1	Translation of letter of credit agreement with ICBC (1)

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10.11	Translation of Executive Officer Employment Agreement for Ping Chen (1)
10.12	Translation of Executive Officer Employment Agreement for Weibing Yang (1)
10.13	Translation of Executive Officer Employment Agreement for Zheng Liu (1)
10.14	Translation of Executive Officer Employment Agreement for Yong Wang (1)
10.15	Translation of Form of Purchase Agreement with Poverty Aid Office (1)
10.16	Translation of Production Agreement with Friend of Health (Chuzhou) Medical

	Technology Co., Ltd. (1)
10.17	Translation of Guarantee Contract between Ping Chen and ICBC (1)
10.18	Mortgage Contract between ICBC and BTL (1)
10.19	Indemnification and Guarantee Contract between Ping Chen and BTL (1)
10.20	Description of oral loan contract between BTL and BDL (1)
10.21	Translation of approval dated November 17, 2009 to change ICBC loan repayment schedule (1)
10.22	Loss Absorption Agreement between BDL, BTL and shareholders of BTL (1)
10.23	Translation of approval dated March 18, 2010 to change ICBC loan repayment schedule (1)
21.1	Subsidiaries of the Registrant (1)
31.1	Certifications pursuant to Rule 13a-14(a) or 15(d)-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (2)
31.2	Certifications pursuant to Rule 13a-14(a) or 15(d)-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (2)
32.1	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (2)
32.2	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (2)
99.1	Code of Business Conduct and Ethics (1)
99.2	Audit Committee Charter (3)

(1) Incorporated by reference to the registrant's registration statement on Form S-1, File no. 333-163041, filed on November 12, 2009, as amended.

(2) Filed herewith.

(3) Incorporated by reference to the registrant's annual report on Form 10-K, File no. 001-34661, filed on March 31, 2010.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DEHAIER MEDICAL SYSTEMS LIMITED

November 12, 2010	By:	/s/ Zheng (Rita) Liu
		Zheng (Rita) Liu
		Chief Financial Officer
		(Principal Financial and Accounting Officer)

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DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

INDEX TO FINANCIAL STATEMENTS

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DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	September 30, 2010	**December 31, 2009**
	US$	**US$**
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	4,964,450	1,151,721
Accounts receivable		
- less allowance for doubtful accounts of $ 74,179 and	9,074,841	6,891,291

$102,939		
Other receivables	3,107,351	1,499,111
Prepayment and other current assets	6,124,933	1,691,387
Inventories, net	4,301,025	2,326,126
Total Current Assets	27,572,600	13,559,636
Property and equipment, net	3,541,763	2,862,625
Tax receivable	2,450,681	1,362,372
Total assets	33,565,044	17,784,633
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Short-term borrowings	1,495,000	1,464,770
Accounts payable	37,095	93,770
Advances from customers	436,625	174,253
Accrued expenses and other current liabilities	256,126	336,412
Tax payable	6,998,807	4,993,387
Warranty obligation	182,444	178,755
Warrants liability	155,194	—
Due to officer	—	3,861
Total Current Liabilities	9,561,291	7,245,208
Commitments and contingency		
Shareholders' equity		
Common stock, $0.002731 par value, 18,307,038 shares authorized, 4,500,000 and 3,000,000 shares issued and outstanding at September 30, 2010 and December 31, 2009, respectively	12,290	8,193
Additional paid in capital	13,137,085	3,196,974
Retained earnings	8,365,939	5,298,742
Accumulated other comprehensive income	1,185,177	773,127
Total Dehaier Medical Systems Limited shareholders' equity	22,700,491	9,277,036
Non-controlling interest	1,303,262	1,262,389
Total shareholders' equity	24,003,753	10,539,425
Total liabilities and shareholders' equity	33,565,044	17,784,633

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	For the nine months ended September 30,		For the three months ended September 30,	
	2010	2009	2010	2009
	US$	US$	US$	US$
Revenue	12,930,769	9,422,460	5,458,818	3,588,442
Costs of revenue	(7,776,867)	(5,688,352)	(3,199,072)	(2,101,639)
Gross profit	5,153,902	3,734,108	2,259,746	1,486,803
Service income	274,154	298,036	92,648	101,708
Service expenses	(108,825)	(113,066)	(40,479)	(38,085)
General and administrative expense	(875,840)	(787,784)	(355,431)	(159,203)
Selling expense	(834,279)	(544,470)	(351,469)	(152,776)
Operating Income	3,609,112	2,586,824	1,605,015	1,238,447
Financial expenses (including interest expense of $48,255, $67,704, $21,452 and $23,772)	(98,411)	(66,384)	(43,725)	(21,302)
Change in fair value of warrants liability	114,806	—	96,412	—
Income before provision for income taxes and non-controlling interest	3,625,507	2,520,440	1,657,702	1,217,145
Provision for income tax	(543,749)	(410,162)	(245,569)	(183,712)
Net income	3,081,758	2,110,278	1,412,133	1,033,433
Non-Controlling interest in income	(14,561)	(38,502)	(4,570)	(14,782)
Net income attributable to Dehaier Medical Systems Limited	3,067,197	2,071,776	1,407,563	1,018,651
Earnings per share				
-Basic	0.79	1.10	0.31	0.54
-Diluted	0.77	0.69	0.30	0.34
Weighted average number of common shares used in computation				

-Basic	3,887,868	1,891,930	4,500,000	1,891,930
-Diluted	3,981,094	3,000,000	4,657,500	3,000,000

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	For the nine months ended September 30	
	2010	**2009**
	US$	**US$**
Operating Activities		
Net income	3,081,758	2,110,278
Adjustment to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization	261,438	210,231
Recovery of doubtful accounts	(30,336)	—
Recovery of inventory obsolescence	(5,756)	—
Change in fair value of warrants liability	114,806	—
Provision for warranty reserve	3,689	41,662
Change in assets and liabilities		
Increase in accounts receivable	(2,153,214)	(642,778)
Decrease (increase) in prepayments and other current assets	(4,433,546)	498,145
Increase in other receivable	(1,608,240)	(274,275)
Increase in inventories	(1,969,143)	(1,050,453)
Increase in tax receivable	(1,088,309)	(610,511)
(Decrease) increase in accounts payable	(56,675)	5,536
(Decrease) increase in advances from customers	262,372	(170,699)
(Decrease) increase in accrued expenses and other current liabilities	(80,286)	46,609
Increase in tax payable	2,005,420	1,409,645
Net cash provided by (used in) operating activities	(5,696,022)	1,573,390
Investing Activities		
Capital expenditures and other additions	(839,456)	(915,693)
Proceeds from (advances to) related parties	(3,861)	1,976

Net cash used in investing activities	(843,317)	(913,717)
Financing Activities		
Net proceeds from issuance of common stock	9,944,207	—
Net cash provided by financing activities	9,944,207	—
Effect of exchange rate fluctuations on cash and cash equivalents	407,861	(4,306)
Net increase in cash and cash equivalents	3,812,729	655,367
Cash and cash equivalents at beginning of period	1,151,721	282,603
Cash and cash equivalents at end of period	4,964,450	937,970
Supplemental cash flow information		
Income tax paid	17,197	12,824
Interest paid	48,255	67,704

The accompanying notes are an integral part of these condensed consolidated financial statements.

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DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND PRINCIPAL ACTIVITIES

Dehaier Medical Systems Limited ("Dehaier") was incorporated in the British Virgin Islands in 2003 as a limited liability company. Dehaier distributes and provides after-sale services for medical equipment in China mainly through its majority-owned subsidiary Beijing Dehaier Medical Technology Co. Limited ("BDL") and its affiliate Beijing Dehaier Technology Limited ("BTL"). On October 23, 2003, Dehaier established a wholly-owned subsidiary in Hong Kong, De-haier Medical System (Hong Kong) Limited ("DHK"), (collectively, the "Company"). Both BDL and BTL were incorporated in the People's Republic of China ("PRC"). The Company distributes branded, proprietary medical equipment, such as sleep apnea machines, patient monitors, air compressors, and oxygen generators; moreover, standard product registration, product certification and quality management system have been established in the Company. ISO13485 industry standard has also already been passed. It also has the distribution rights for a number of international medical equipment suppliers for products including anesthesia equipment, patient monitors, mobile C-arm X-ray machines and other medical equipment accessories.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying condensed consolidated financial statements of the Company are prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

In the opinion of the Company's management, the unaudited condensed consolidated financial statements include all adjustments necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company for the periods presented. The results of operations for the three and nine months ended September 30, 2010 are not necessarily indicative of operating results expected for the full year or future interim periods. These unaudited condensed consolidated financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, filed on March 31, 2010 (the "Annual Report").

Basis of Consolidation

The consolidated financial statements include the accounts of Dehaier, BDL, its majority-owned subsidiary, and its wholly-owned subsidiary, DHK as well as BTL. All significant inter-company transactions and balances are eliminated in consolidation.

A group of shareholders, including the Chief Executive Officer, originally held more than 50% of the voting ownership interest of Dehaier, BDL and BTL. BTL is a variable interest entity, and BDL is the primary beneficiary. BTL owns a building which is pledged as collateral for BDL's bank loans. In exchange, BDL loans money to BTL to finance its operations. BTL's primary operation is to provide repairs and transportation services to BDL's customers. Because of these arrangements, BDL is the primary beneficiary of BTL, as the entity that is most closely associated with BTL. Dehaier has included BTL in its consolidated financial statements through the consolidation with BDL since December 31, 2006. Dehaier, BDL and BTL were under common control until October 31, 2009, when each share of preferred share was converted into a common share (see Note 9). Because the Chief Executive Officer held more than 50% of the voting ownership interest of each of Dehaier, BDL, BTL and DHK at December 31, 2006, the Company initially measured the assets, liabilities and noncontrolling interest of the variable interest entity at the amounts at which they were carried in the accounts of the reporting entity that controls the variable interest entity pursuant to FASB ASC 810-10.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-continued

Basis of Consolidation-continued

On October 31, 2009, BDL reconsidered whether it was the primary beneficiary of BTL when Dehaier's preferred stock was converted into common shares. While such conversion dilutes the Chief Executive Officer's interest in BDL such that BDL and BTL are not under common control after October 31, 2009, BDL still has the obligation to absorb the expected losses of BTL. BTL is still a variable interest entity because all of its activities either involve or are conducted on behalf of the reporting enterprise and its related parties. BDL is BTL's only customer referral source. On March 3, 2010, BDL entered into a Loss Absorption Agreement memorializing the understanding that BDL would continue to loan money to BTL as needed to fund its working capital such that BDL would absorb BTL's losses.

The carrying amount and classification of BTL's assets and liabilities included in the Condensed Consolidated Balance Sheets are as follows:

	September 30, 2010	December 31, 2009
	US$	US$
	(unaudited)	
Total current assets	440,075	240,195
Total assets	1,516,336	1,330,139
Total current liabilities	213,074	67,750
Total liabilities	213,074	67,750

The accounts of BTL are consolidated in the accompanying financial statements pursuant to Accounting Standards Codification ("ASC") 810-10, "Consolidation". As a VIE, BTL's revenues are included in the Company's service income, and its income from operations is consolidated with the Company's. Because of the arrangements, the Company had a pecuniary interest in BTL that requires consolidation of the Company's and BTL's financial statements.

On January 1, 2009, the Company adopted the transition rules within ASC 810-10-65, regarding accounting and reporting standards for the non-controlling interest in a subsidiary.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Estimates are adjusted to reflect actual experience when necessary. Significant accounting estimates reflected in the Company's condensed consolidated financial statements include revenue recognition, allowance for doubtful accounts, inventory obsolescence, warranty obligation, warrants liability and useful lives of property and equipment. Actual results could differ from those estimates.

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DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-continued

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and highly liquid investments which are unrestricted as to withdrawal or use, and which have maturities of three months or less when purchased. The Company maintains uninsured cash and cash equivalents with various financial institutions mainly in the PRC and Hong Kong.

Accounts Receivable

Accounts receivable are recorded at net realizable value. Accounts receivable terms typically are 60 to 180 days from the end of the month in which the services were provided or when goods were delivered. The Company generally does not require collateral or other security to support accounts receivable. An allowance, if required, is based on a combination of historical experience, aging analysis, and an evaluation of the collectability of specific accounts. Receivables are considered past due after 3 years and written off. In accordance with the accounting policies, management has determined that an allowance of $74,179 and $102,939 was required at September 30, 2010 and December 31, 2009, respectively.

Advances to Suppliers and Advances from Customers

The Company, as is the common practice in the PRC, will often pay advance payments to suppliers for unassembled parts, or receive advance payments from customers. Advances to suppliers were $6,080,266 and $1,511,540 as of September 30, 2010 and December 31, 2009, respectively, which were included in prepaid expenses and other current assets. Advances from customers were $436,625 and $174,253 as of September 30, 2010 and December 31, 2009, respectively.

DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-continued

Fair Value of Financial Instruments

The carrying amounts reported in the consolidated financial statements for current assets and current liabilities approximate fair value due to the short-term nature of these financial instruments.

The Company follows the provisions of ASC 820-10, “Fair Value Measurements and Disclosures”, which establishes a single authoritative definition of fair value and a framework for measuring fair value and expands disclosure of fair value measurements for both financial and nonfinancial assets and liabilities. This standard defines fair value, provides guidance for measuring fair value and requires certain disclosures. This standard does not require any new fair value measurements, but discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flows) and the cost approach (cost to replace the service capacity of an asset or replacement cost). For purposes of ASC 820-10-15, nonfinancial assets and nonfinancial liabilities would include all assets and liabilities other than those meeting the definition of a financial asset or financial liability as defined in ASC 820-10-15-15-1A.

On August 26, 2009, the FASB issued Accounting Standard Update (ASU) 2009-05, Measuring Liabilities at Fair Value, to clarify how entities should estimate the fair value of liabilities under the FASB ASC Topic 820, Fair Value Measurements and Disclosures. The amendments in ASU 2009-05 reduce potential ambiguity in financial reporting when measuring the fair value of liabilities. Therefore, preparers, investors, and other users of financial statements will have a better understanding of how the fair value of liabilities was measured, helping to improve consistency in the application of Topic 820. The FASB issued ASU 2009-05 as a result of expressed concern that there may be a lack of observable market information to measure the fair value of a liability. For example, in the hypothetical transfer of an asset subject to a restriction there will be no observable data available to measure the liability because it is restricted from being transferred. This guidance is effective for the first reporting period (including interim periods) beginning after issuance.

The Company adopted the provisions of ASC topic 815 (formerly Emerging Issue Task Force 07-5), “Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity’s Own Stock”. ASC topic 815 provides a framework for determining whether an instrument is indexed to an entity’s own stock. ASC topic 815 became effective for the Company when warrants were issued in connection with the Company’s initial public offering. Such warrants are indexed to the Company’s stock, which is traded in US dollars. Since the Company’s functional currency is the RMB, such warrants are considered liabilities. The fair value of the warrants liability is measured each reporting period with the resulting change in fair value recorded in the statement of operations (see Note 10).

Inventories

Inventories are stated at the lower of cost or market and consist of assembled and unassembled parts relating to medical devices. The Company reviews its inventories annually for possible obsolete goods and to determine if any reserves are necessary. At September 30, 2010, the reserve for obsolescence was $48,223. At December 31, 2009, the reserve for obsolescence was $52,989, and the provision is included in the operating expenses in the condensed consolidated statements of operations.

DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-continued

Property and Equipment

Property and equipment are recorded as cost less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over the following estimated useful lives:

Leasehold improvements	Shorter of the useful lives or the lease term
Building and land use rights	20-40 years
Machinery and equipment	10-15 years
Furniture and office equipment	5 years
Motor vehicles	5 years

Impairment of Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. When these events occur, the Company measures impairment by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to result from the use of the asset and eventual disposition. If the sum of the expected future cash flows is less than the carrying amount of the asset, an impairment loss, equal to the excess of the carrying amount over the fair market value of the asset, is recognized. Management has determined no impairment exists at the balance sheet dates.

Revenue Recognition

The Company recognizes revenues when all the following conditions have been satisfied:

- Persuasive evidence of an arrangement exists;
- Delivery and/or installation has occurred (e.g., risks and rewards of ownership have passed);
- The sales price is fixed or determinable; and,
- Collectability is reasonably assured.

All revenues are based on firm customer orders with fixed terms and conditions. Because the products are assembled to the customers’ specification, there is no right of return. The Company does not provide its customers with price protection or cash rebates. For products which include software, the software is an off-the-shelf package and an integral part of the products being delivered. The Company does not provide any significant post-sale customer support services and does not provide customers with upgrades. The software is incidental to the product as a whole. For products that do not require installation, revenues are recognized when the products are delivered. For products that require installation, revenues are recognized when the installation is completed.

For all service income, the Company recognizes the revenue upon the completion of the repairs when the equipment has been returned to and accepted by the customers.

In the PRC, value added tax (VAT) of 17% of the invoice amount is collected in respect of the sales of goods on behalf of tax authorities. The VAT collected is not revenue of the Company; instead, the amount is recorded as a liability on the balance sheet until such VAT is paid to the authorities.

Cost of Revenues

Cost of revenues primarily includes wages to assemble parts and the costs of unassembled parts, handling charges, and other expenses associated with the assembly and distribution of product.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-continued

Service income and expense

Service income and expense represents activities related to repair and transportation service provided for the customers by BTL.

Foreign Currency Translation

The accounts of Dehaier, BDL, BTL and DHK are measured using the currency of the primary economic environment in which the entity operates (the “functional currency”). The accompanying consolidated financial statements are presented in US dollars. Foreign currency transactions are translated into US dollars using fixed exchange rates in effect at the time of the transaction. Generally, foreign exchange gains and losses resulting from the settlement of such transactions are recognized in the consolidated statements of operations. The foreign currency accounts of DHK, BDL and BTL are translated in accordance with ASC 830-10, “Foreign Currency Matters”. Assets and liabilities are translated at current exchange rates quoted by the People’s Bank of China at the balance sheet dates and revenues and expenses are translated at average exchange rates in effect during the periods. Resulting translation adjustments are recorded as other comprehensive income (loss) and accumulated as a separate component of equity in non-controlling interest.

Warranty Costs

The Company provides for the estimated cost of product warranties at the time revenue is recognized. Warranty costs are included in general and administrative expenses. The Company’s warranty obligation is affected by product failure rates and material usage and service delivery costs incurred in correcting product failure. Should actual product failure rates, material usage or service delivery costs differ from the Company's estimates, the Company may be required to revise its estimated product warranty liability. The term of the product warranty is generally twelve months. The reserve for warranty costs was $182,444, $178,755 at September 30, 2010 and December 31, 2009, respectively. Warranty expense for the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009 were $111,076, $83,588, $45,654 and $37,422, respectively.

Research and Development Costs

Research and development costs relating to the development of new products and processes, including significant improvements and refinements to existing products, are expensed as incurred. Research and development costs were $51,085, $50,671, $24,032 and $34,392 for the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009, respectively.

Shipping and Handling Expenses

Shipping and handling expenses of $49,130, $49,591, $20,277 and $23,195 for the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009 were included in the operating expenses in the condensed consolidated statements of operations, respectively.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs were $80,296, $42,758, $18,056 and $25,329 for the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009, respectively.

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2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES-continued

Earnings Per Share

The Company follows the provisions of ASC 260-10, "Earnings Per Share". Basic earnings per share is computed by dividing net income attributable to holders of common shares by the weighted average number of common shares outstanding during the years. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted into common shares. Convertible preferred shares are included in the computation of diluted earnings per share on an "if converted" basis, when the impact is dilutive.

The following table sets forth computation of basic and diluted weighted average share information:

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Weighted average number of common shares outstanding	3,887,868	1,891,930	4,500,000	1,891,930
Dilutive effect of convertible preferred shares	—	1,108,070	—	1,108,070
Dilutive effect of warrants	93,226	—	157,500	—
Weighted average number of common shares outstanding, assuming dilution	3,981,094	3,000,000	4,657,500	3,000,000

Value Added Tax

The Company reports revenues net of PRC's value added tax for all the periods presented in the consolidated statements of operations.

Stock-Based Compensation

The Company follows the provisions of ASC 718-10, "Share-Based Payment Arrangement." On December 7, 2009, the Company's Board of Directors and shareholders have approved the creation of a share incentive plan to be implemented after the Company has completed its public offering, which occurred on March 22, 2010. This plan authorizes the issuance of up to 10% of the number of shares outstanding after the Company has completed its public offering. Pursuant to the plan, the Company may issue options to purchase its common shares to employees and directors of the Company and its affiliates. The Company will fair value share-based awards to be granted under the plan. Accordingly, compensation will be measured on the grant date using appropriate valuation models. As of September 30, 2010, no options were issued under this plan.

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Income Taxes

The Company uses the asset and liability method of accounting for income taxes in accordance with ASC 740-10, “Accounting for Income Taxes.” Under this method, income tax expense is recognized for the amount of: (i) taxes payable or refundable for the current year; and, (ii) deferred tax consequences of temporary differences resulting from matters that have been recognized in an entity’s financial statements or tax returns. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is provided to reduce the deferred tax assets reported if, based on the weight of available positive and negative evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of September 30, 2010 and December 31, 2009, the Company was not required to record any deferred tax assets or liabilities.

ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition of a tax position taken or expected to be taken on a tax return. Under ASC 740-10, a tax benefit from an uncertain tax position taken or expected to be taken may be recognized only if it is “more likely than not” that the position is sustainable upon examination, based on its technical merits. The tax benefit of a qualifying position under ASC 740-10 would equal the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all the relevant information. A liability (including interest and penalties, if applicable) is established in the financial statements to the extent a current benefit has been recognized on a tax return for matters that are considered contingent upon the outcome of an uncertain tax position. Related interest and penalties, if any, are included as components of income tax expense and income taxes payable. The Company is awaiting resolution of certain complex tax issues and has not yet filed its 2008 and 2009 Value Added Tax (“VAT”) returns for some of its customers. However, all the potential VAT liabilities on these VAT returns were accrued and included in the accompanying consolidated financial statements.

The implementation of ASC 740-10 resulted in no material liability for unrecognized tax benefits and no material change to the beginning retained earnings of the Company. As of September 30, 2010 and December 31, 2009, the Company did not have a liability for any unrecognized tax benefits. The Company recognizes interest and penalties, if any, related to unrecognized tax benefits as income tax expense in the statement of operations. During the nine months ended September 30, 2010 and the year ended December 31, 2009, the Company did not incur any interest or penalties.

Income tax returns for the year prior to 2007 are no longer subject to examination by tax authorities.

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3. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets consist of the following:

	September 30 2010	December 31 2009
	US$	US$
Advances to suppliers	548,618	358,607
Prepayment for equipment purchase	5,531,648	1,152,933
Initial public offering expenses	—	102,500
Other prepaid expenses	44,667	77,347
	6,124,933	1,691,387

4. PROPERTY AND EQUIPMENT, NET

Property and equipment consist of the following:

	September 30 2010	December 31 2009
	US$	US$
Buildings	1,272,275	1,215,349
Land use rights	290,628	284,751
Plant and machinery	2,728,422	1,947,512
Automobiles	77,380	56,142
Office and computer equipment	389,641	290,183
	4,758,346	3,793,937
Less: Accumulated depreciation and amortization	(1,216,583)	(931,312)
Property and equipment, net	3,541,763	2,862,625

At September 30, 2010 and December 31, 2009, BTL's building was pledged to a bank as collateral for short-term borrowings of RMB 10,000,000 (US$ 1,495,000) and RMB 10,000,000((US$ 1,464,770), respectively (see Note 6).

Depreciation and amortization expense was $261,438, $210,231, $89,124 and $71,219 for the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009, respectively.

Land Use Rights

There is no private ownership of land in China. Land is owned by the government and the government grants land use rights for specified terms. The Company's land use rights are reported at the purchase price (RMB1,944,000 in 2002).

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5. TAX RECEIVABLE

Tax receivable consists of the following:

	September 30, 2010	December 31, 2009
	US$	US$
Value added tax receivable	2,450,681	1,362,372

Enterprises or individuals who sell commodities, engage in repair and maintenance or import and export goods in the PRC are subject to a Value Added Tax (VAT) in accordance with Chinese taxation laws. The standard VAT is 17% of the gross sales price. A credit is available whereby VAT paid on the purchases of unassembled medical components of the Company's product used in contract and production can be used to offset the VAT due on sales of the product.

The tax receivable as of September 30, 2010 and December 31, 2009 represents VAT credit on the purchased products. These amounts can be used to offset the VAT due on sales of the finished product.

6. SHORT-TERM BORROWINGS

The Company has a line of credit for RMB10,000,000 with a commercial bank in China to finance its working capital. The credit line bears interest at a variable rate and is renewed annually on May 18th. Average interest rates for the years ended December 31, 2009 and 2008 were 5.58% and 7.84%, respectively. Pursuant to the terms of the agreement, the line of credit is secured by BTL's building (see note 4) and guaranteed by BDL and an officer of the Company.

On June 14, 2010, the bank renewed the Company's credit line that bears interest at a variable rate with payments due on June 14, 2011.

7. NON-CONTROLLING INTEREST

Non-controlling interest consists of the following:

	September 30, 2010	December 31, 2009
	US$	US$
Original paid-in capital	384,211	384,211
Retained Earnings	715,422	700,861
Accumulated other comprehensive income	203,629	177,317
	1,303,262	1,262,389

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8. COMMITMENTS AND CONTINGENCY

Leases

The lease commitments are for office premises and a warehouse facility, all of which are classified as operating leases. These non-cancelable leases have lease terms expiring through April 2012. Approximate future minimum lease payments under these leases at September 30, 2010, are as follows:

Future payments for the twelve months Ending September 30,	US$
2011	156,000
2012	65,000
Total minimum lease payments	221,000

Rent expense for the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009 was $77,702, $36,174, $21,097 and $9,933, respectively.

Rent expense paid to the spouse of the chief executive officer for the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009 was $11,638, $17,418, $7,489 and $7,456, respectively.

On December 15, 2009, BTL agreed to lease its building to BDL free of any charges through September 24, 2010. BDL is currently negotiating a new lease with BTL.

Employment Contracts

Under the PRC labor law, all employees have signed employment contracts with the Company. Management employees have employment contracts with terms up to three years and non-management employees have a one year employment contract renewable on an annual basis.

Contingency

The Labor Contract Law of the People's Republic of China, effective as of January 1, 2008, requires employers to assure the liability of the severance payments if employees are terminated and have been working for the employers for at least two years prior to January 1, 2008. The Company has estimated its possible severance payments of approximately $178,000 as of September 30, 2010, which have not been reflected in its condensed consolidated financial statements, because it is not more likely than not that this will be paid or incurred.

DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

9. SHAREHOLDERS' EQUITY

Common Shares

At December 31, 2008, the Company's Memorandum and Articles of Association authorized share capital of US $50,000 comprised of 4,500,000 common shares and 500,000 Preferred Shares (120,000 shares of Series A Preferred Shares and 380,000 shares of Series B Preferred Shares) with US$0.01 par value.

On October 31, 2009, the board of directors approved a 3.6614-for-1 stock split of the Company's common shares. Accordingly, all common share and per share information in the accompanying condensed consolidated financial statements give retroactive effect to the stock split. Prior to the stock split, there were 516,722 common shares issued and outstanding at December 31, 2008. The authorized share capital remains at US$50,000.

On March 22, 2010, the founders of the Company placed an aggregate of 600,000 common shares of the Company into escrow. Such shares equal 40% of the maximum number of shares sold in the initial public offering ("IPO"). The shares will remain in escrow until such time as the Company files its

Form 10-K with the Securities and Exchange Commission for the year ending December 31, 2010. The shares in escrow (Make-Good Shares) are accounted for as an element in the IPO and the Company will not recognize any compensation expense upon the return of such Make-Good Shares to the holders. To the extent the Company's earnings per share for the year ending December 31, 2010 are less than $.80, the Company shall redeem, pro rata, such shares. Alternatively, if the closing price of the common shares is equal to at least 2.5 times the IPO offering price for five trading days in any period, then the Make-Good Shares will be returned to the founders. These shares are included as part of the calculation of the basic and diluted earnings per share for the three and nine months ended September 30, 2010 and 2009 in the accompanying condensed consolidated financial statements.

The Company completed its IPO on April 22, 2010 and is listed on Nasdaq Capital Market. On April 22, 2010, the Company sold 1,500,000 common shares at $ 8.00 per share for US$ 12,000,000 before the IPO costs.

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9. SHAREHOLDERS' EQUITY-continued

Convertible Preferred Shares

In October 2003, the Company issued 120,000 Series A convertible preferred shares ("Series A Preferred Shares") for total proceeds of $1,200,000.

During 2007, the Company issued in aggregate 182,635 Series B convertible preferred shares ("Series B Preferred Shares") for total proceeds of $2,000,000. On October 31, 2009, each share of preferred stock was converted into common shares on a 1-to-1 basis. In addition, all preferred shares in authorized capital on October 31, 2009, were re-designated as common shares.

Series A Preferred Shares and Series B Preferred Shares are collectively referred to as the "Preferred Shares".

Preferred Shares have priority over the common stock "Ordinary Shares". Certain rights, preferences and privileges of the Preferred Shares are listed below:

The holders of Preferred Shares are entitled to receive noncumulative dividends, when and if declared by the board of directors. Dividends are not mandatory and shall not accrue.

Preferred Shares Series A and B have a liquidation preference of $10 and $10.95074 per share, respectively.

The holders of Preferred Shares are entitled to one vote for each share of common stock the Preferred Shares could be converted to.

Preferred Shares are non-redeemable.

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9. SHAREHOLDERS' EQUITY-continued

Statutory Surplus Reserves

A PRC company is required to make appropriations to statutory surplus reserve, based on after-tax net income determined in accordance with generally accepted accounting principles of the PRC ("**PRC GAAP**"). Appropriations to the statutory surplus reserve is required to be at least 10% of the after tax net income determined in accordance with PRC GAAP until the reserve is equal to 50% of the entity's' registered capital.

The statutory surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholding or by increasing the par value of shares currently held by them, provided that the remaining statutory surplus reserve balance after such issue is not less than 25% of the registered capital.

Since Dehaier is a British Virgin Islands' company, it will not be subject to the statutory surplus reserve provisions. BDL is a joint-venture company and the statutory surplus reserve provisions will be determined by its board of directors. As of September 30, 2010, BDL's board of directors has not yet made such determination. Therefore, no amount was allocated to the statutory surplus reserve account.

BTL appropriated 10% of its net profits as statutory surplus reserve, which is included as part of the non-controlling interest in the equity section. For the nine months ended September 30, 2010, statutory surplus reserve activity was as follows:

	US$
Balance – December 31, 2009	70,086
Addition to statutory reserves	1,456
Balance – September 30, 2010 (Unaudited)	71,542

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DEHAIER MEDICAL SYSTEMS LIMITED AND AFFILIATE

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

10. WARRANTS

On April 21, 2010, the Company issued to Anderson & Strudwick Incorporated ("A&S") 150,000 warrants, as a portion of the placement commission for the IPO. On the same day, the Company granted a total of 7,500 warrants to Hawk Associates Inc. ("Hawks"), the Company's investor relations consultancy. The Company had 157,500 warrants outstanding as of September 30, 2010. All the warrants issued to "A&S" have the right to purchase one share of common stock for an exercise price of $10.00 per share with a term of 5 years. All the warrants granted to Hawks have the right to purchase one share of common stock for an exercise price of $9.60 per share with a term of 5 years.

The fair value of the outstanding warrants at September 30, 2010 for A&S was calculated using the Black Scholes Model with the following assumptions:

Fair value per share (USD/share)	5.24(1)
Exercise price (USD/share)	10.00(2)
Risk free rate	1.25%(3)
Dividend yield	— (4)
Expected term/Contractual Life (number of years)	4.5(5)
Expected volatility	45%(6)

The fair value of the outstanding warrants at September 30, 2010 for Hawks was calculated using the Black Scholes Model with the following assumptions:

Fair value per share (USD/share)	5.24(1)
Exercise price (USD/share)	9.60(2)
Risk free rate	1.25%(3)
Dividend yield	— (4)
Expected term/Contractual Life (number of years)	4.5(5)
Expected volatility	45%(6)

(1) Fair Value of Underlying Ordinary Shares

The $5.24 is the close price of the Company on September 30, 2010.

(2) Exercise price

The exercise price of the warrants was determined by the Company's board of directors.

(3) Risk-free interest rate

Risk-free interest rate was estimated based on the yield to maturity of U.S. Treasury notes with a maturity period close to the term of the warrants.

(4) Dividend yield

Dividend yield of 0% was estimated by management of the Company.

(5) Life to Expiration

Life to expiration was based on contractual term of the warrants.

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10. WARRANTS-continued

(6) Volatility

The volatility of the underlying ordinary shares during the life of the warrants was estimated based on the historical stock price volatility of listed comparable companies over a period comparable to the expected term of the warrants.

The fair value of the each A&S warrant at September 30, 2010 was $1.03. The total fair value of such warrants was $155,194 at September 30, 2010.

The fair value of the warrants for A&S was $270,000 on the date of grant which was recognized as IPO expense. The decrease in the fair value of the warrants during the period was recognized as a change in fair value of warrants liability which was included in statements of operations.

The fair value of each Hawks warrant at September 30, 2010 was $1.09. The total fair value of such warrants was $8,161, which has not been reflected in the Company’s condensed consolidated financial statements due to immateriality. The fair value of the warrants for Hawk at the grant date was $15,000. The decrease in fair value of the warrants resulted in a gain of $6,839, which has not been reflected in the Company’s condensed consolidated financial statements due to immateriality.

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11. INCOME TAXES

British Virgin Islands

Dehaier is a tax-exempt company incorporated in the British Virgin Islands. BDL and BTL were incorporated in the PRC and are governed by the PRC laws.

Hong Kong

DHK is subject to Hong Kong profits tax at a rate of 16.5% on its assessable profits. No Hong Kong profits tax has been provided as the Company did not have any taxable profit that was earned in or derived from Hong Kong during the years presented.

PRC

PRC enterprise income tax is calculated based on the Enterprise Income Tax Law (the “EIT Law”). Under the EIT Law, a unified enterprise income tax rate of 25% and unified tax deduction standards will be applied equally to both domestic-invested enterprises and foreign-invested enterprises.

Under the current PRC laws, PRC government grants a preferential income tax rate of 15% to government-certified high technology companies, and under the new standard the period of validity for the certification of high technology companies is three years. In 2009, BDL updated its certification for “high technology” company. Therefore, BDL used a 15% income tax rate to calculate the income tax expense for periods ended September 30 2010 and 2009.

The tax rate for BTL is 25% in 2009 and 2010.

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12. RELATED PARTY TRANSACTIONS

At December 31, 2009, the amount due to an officer of $3,861 represents expenses paid by an officer of the Company. This amount was repaid in the first six months of 2010.

13. CONCENTRATIONS

Major Customers

For the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009 approximately 11%,8%, 19% and 15% , respectively, of the Company's revenues were to one customer.

At September 30, 2010 and December 31, 2009, receivables from four customers were approximately 11%, 11% 8%, 8% and 9%, 8%, 8%, 7%, respectively.

Revenues

For the nine months ended September 30, 2010 and 2009, and for the three months ended September 30, 2010 and 2009, the Company's three top selling products accounted, in the aggregate, for approximately 51%, 56%, 53% and 54%, respectively, of its total net revenues.

The following represents the revenues by products, all derived from China:

	Nine Months Ended September 30,		Three Months Ended September 30,	
Products	**2010**	**2009**	**2010**	**2009**
	US$	**US$**	**US$**	**US$**
Medical Devices	8,280,617	7,292,406	3,077,051	2,949,568
Technical Service	2,489,467	1,231,993	1,120,620	338,456
Respiratory and Oxygen Homecare	2,160,685	898,061	1,261,147	300,418
	12,930,769	9,422,460	5,458,818	3,588,442